

**USAID/Ecuador**

**Annual Report**

**FY 2005**

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## Ecuador

### Performance:

Background: In 2004, Ecuador celebrated 25 years of civilian governance. Despite this promising milestone, the roots of an effective democratic governance system have been continuously threatened by political in-fighting, a dysfunctional multi-party political system, a growing dissatisfaction with democratic institutions in an underserved populace, and a lack of consensus on key social and economic reforms to advance economic growth. Ecuador has seen five presidents in the last six years. National surveys continue to confirm that a majority supports authoritarian rule if it leads to better economic conditions - a trend that has the U.S. Mission very concerned. The current Government of Ecuador (GOE) is weak, have suffered numerous changes in cabinets which have stalled major reform efforts, and ultimately has hampered the effectiveness of governance institutions across the range of sectors in which the U.S. Mission is engaged. Corruption scandals have further fueled distrust among many social and economic groups. The security situation in the northern border with Colombia reflects gradually increasing numbers of displaced and incursions by narco-terrorist groups. Over the last year, GOE leadership toward resolution of these long term issues were distracted by numerous internal crises including threats to remove the President from power, extensive shuffles in cabinet and other government positions, and deal-making with Congress. A lack of political stability, waning commitment to meaningful reform and an eroded public confidence continuously inhibit substantive attainment of longer term U.S. foreign policy and Ecuadorian national interests.

A recent survey reflected greater Ecuadorian trust in local governance over national level institutions. USAID-supported local elections in October 2004 yielded new mayors and prefects, and city and provincial council leadership throughout the country's 22 provinces. The results strengthened party opposition thus creating an increasingly fractured governance system. Even more cabinet level shuffles are expected. Further shifts were recently observed as key positions of the Electoral Tribunal and Constitutional Tribunal were made due to internal political alliance building. The Ecuadorian Congress is now reviewing its 2005 budget and will choose its new leadership in January 2005. The outcomes of all of these challenges will influence future legislative-executive relations, the progress on Ecuador's policy-making agenda (including legislation on Trafficking in Persons, labor code reforms, and money laundering) and ultimately the success of the U.S. Mission's longer term development goals.

The lack of economic opportunity in Ecuador has continued to lead to internal and international migration, trafficking in persons, and greater engagement in illicit activity including drug trafficking. While violence has not substantially increased along the border with Colombia, evidence has shown that crime is increasing due to the influx of Colombian refugees, drug traffickers, and narco-terrorists.

Ecuador's stability goes beyond the question of its porous borders and fragile democracy. Ecuador suffers from macroeconomic instability and poor competitiveness. Symptoms include a weak revenue base, a large budget deficit, a mismanaged and corrupt customs system, inadequate financial control and information systems, low bank solvency ratios, and high liquidity risk.

On the positive side, Ecuador has a favorable trade balance with the U.S. and inflation has fallen this year to 1.6% down from triple digit figures which scourged the country a few years ago. Its GDP grew 6% last year as a result of increases in oil revenues and strong private consumption.

Despite the country's immense natural resource wealth and potential for growth in key sectors, there was little progress in structural reform and continued statist policies contributed to the expiration of an IMF program in 2004. Real wages have not significantly increased over the last 30 years and nearly two thirds of the country's 13.4 million population remain in dire poverty. Annual per capita national income

has hovered around \$2000, pushed to this level by historically high oil prices. As well, rising oil revenues and remittances have helped the Ecuadorian government cushion rising social tensions and reduce the urgency for reform.

Ecuador has some of the worst human development indicators with an annual population growth rate of 2.1 percent, an infant mortality rate of 30 per 1,000, a high prevalence of infectious diseases (tuberculosis, malaria, and HIV/AIDS), chronic malnutrition, and high levels of maternal and child morbidity. Access to safe water and sanitation is worse than in Peru and Bolivia, and modern health care facilities are limited among urban and rural poor populations. Another worrisome area is the low education levels of adults and children. Ecuador invests approximately 3% of the GDP in education, while UNESCO recommends worldwide investing 6% of the GDP. Access to education varies significantly between urban and rural zones. Rural populations, particularly indigenous peoples, lack education opportunities.

**U.S. Interests and Goals:** The U.S. and Ecuador share goals of strengthening democracy, building the engines of sustainable economic growth through trade, and combating the regional drug trade and narco-terrorism. U.S. Government support for a constitutionally based, democratic system for Ecuador addresses Ecuador's fragile political stability. The USG hopes to strengthen Ecuadorian citizen trust in a democratic form of government through promotion of more transparent and accountable government institutions, enhanced rule of law, elimination of corruption, a local governance system that is more responsive to its citizenry, support of local and national elections, and reducing the illicit trafficking in persons. Economic growth can be further spurred in 2005 through a Free Trade Agreement with Ecuador, continued macroeconomic reform, and expansion of microfinance activities. It is also hoped that a FTA would ease pressure on Ecuador's economy, Ecuador's fragile ecosystems, and reduce poverty and social unrest. Combating terrorism, preventing the spread of narco-trafficking and maintaining regional stability will be addressed through improvements in the quality of lives of thousands of underserved Ecuadorians in geographically focused areas such as the northern and southern border provinces. This includes promotion of licit forms of income through expanded areas of trade, the provision of infrastructure, improved local governance, and improved natural resource management systems.

**Donor Relations:** The GOE has shared information among sectors but has not been effectively coordinating donor activities. While general dialogue takes place with the Ministry of Foreign Affairs on donor programs, extensive coordination and leadership occurs between USAID, donors, and multi-lateral institutions through activity level planning, "round tables", and working groups for policy discussions. Based on the latest information available, total levels of all international non-reimbursable assistance to Ecuador in 2002 are estimated at \$236 million. As the largest bilateral donor of non-reimbursable funds, USAID's leadership is key in areas such as macroeconomic reforms, microfinance, governance and conflict resolution issues in the Galapagos, local governance strengthening, and border integration and alternative development. USAID also regularly coordinates with institutions such as the Inter-American Development Bank, the World Bank, the International Monetary Fund, and the Spanish, Canadian, German, Swiss, and Dutch Cooperation Agencies.

**Challenges:** Ecuador has made efforts to improve health and education conditions, improve agricultural production and incomes, and address shortcomings in governance structures and processes; however, a tremendous amount remains to be done. Ecuador is now faced with deeper challenges that continue to test the democratic form of government. Recent Andean drug studies provide evidence that Ecuador is a major drug transit point and this has significant economic consequences for this struggling country. The threat of conflict spillover of Colombia, porous borders with Colombia and Peru, and lack of economic opportunity, continue to menace the social and economic fiber of the border areas. The impact of a future trade agreement could have far reaching impacts on different sectors including agriculture and pharmaceutical industries. As noted earlier, continued political instability and changes in cabinet ministers may ultimately reverse many of the country's hard won development gains in recent years. Unless major structural reforms are put in place, the potential for further macroeconomic deterioration looms. The country remains plagued by high poverty rates, a lack of adequate infrastructure, weak governmental institutions, the destruction of biodiversity, disruptive protests against governance,

inadequate governmental information bases to lead in establishing development priorities, a large budget deficit, declining human development indicators, and a high dependency on foreign assistance.

In addition to active policy dialogue and public diplomacy efforts, the Mission has strategically focused its response to these challenges by providing support to promote economic growth opportunities, strengthen democracy, and prevent the spread of conflict. Efforts to strengthen local governance systems across a range of municipalities and other local units have shown promise. Indigenous communities have been directly supported in building their community governance and financial management systems as well as improving land titling. Support has also focused on strengthening the financial sector, Ecuadorian trade capacity, engaging in policy dialogue, and macroeconomic reforms. Progress has also been readily seen in building a stronger coalition of NGOs toward protection of Quito's watershed, elements of Ecuador's national park system, the biologically rich indigenous territories in the north, as well as the preservation of the Galapagos Islands' unique ecosystems.

**Key Achievements:** Despite the broader issues impacting Ecuador's overall performance and image, FY 2004 was a year of excellent development results in terms of program impact.

1. **Environment:** With USAID support, three indigenous groups improved the management of over 184,000 hectares and gained greater control over 356,000 hectares of their ancestral territories. They have reached agreements with their neighbors and demarcated 90 miles of their most vulnerable boundaries, helping conserve 1,040,000 hectares of pristine forest. To strengthen the conservation of the Galapagos Marine Reserve, USAID provided technical assistance in governance and sought economic alternatives for destructive fishing practices. In 2004 Ecuador's water fund endowment (FONAG) reached \$1.8 million and invested \$228,800 in seven projects implemented in critical watersheds and leveraged \$381,800 in matching funds from other sources.

2. **Southern Border:** In FY 2004, the program benefited approximately 59,000 people of the southern border provinces. An additional 15 potable waters systems, 1,033 sanitation units and four garbage collection systems were constructed in FY 2004. With USAID assistance, around 41,000 hectares have natural resources management plans in operation. Also, eight additional local governments have adopted better administrative processes to improve tax collections, control warehouses, eliminate opportunities for corruption, and improve resource management.

3. **Democracy:** Public support and confidence in Ecuador's democracy have gradually increased since 2001 when the first Democratic Values Survey (DVS) was undertaken. USAID support is having positive impacts at different levels of the government as it seeks to build greater citizen trust in democracy. USAID support to sub-national elections in October 2004 was essential for effective administration and citizen oversight of this key democratic process which was determined by international observers to be free and fair. USAID has successfully promoted criminal justice reform by improving the capacity of public sector institutions to coordinate activities that will enhance the investigation and prosecution of cases, as well as civil society's capacity to provide legal services to vulnerable groups. As a result, the number of people that have received defense services from legal service providers strengthened by USAID reached around 1,000 in FY 2004. Decentralization efforts have contributed to the formulation and approval of new policies and operative plans. Citizen participation and oversight results were consolidated in the 21 supported municipalities, contributing to an increased level of citizen satisfaction and trust in local governments at the national level, an important target set for this period. A national level program got under way to support a range of institutions implementing a national level decree to root out corruption. Legislation is now in process against trafficking in persons, and the government showed signs of leadership in advancing this reform in several fora.

4. **Northern Border:** In FY 2004, the program achieved success in constraining the expansion of coca/cocaine into Ecuador through investments in social infrastructure and local governance strengthening. Official estimates report only minor fields of less than five hectares were discovered and they were eradicated. However, studies show an increasing impact of sales of precursor chemicals and drugs trans-shipments, which will require long-term USG support to combat, through both development and security assistance. With USAID assistance, 13 water systems, seven sewerage systems and 17

bridges have been built and/or repaired during FY 2004. A Regional Inspector General (RIG) performance audit of the program was very positive and found all infrastructure projects sustainable. Income and employment development activities began in FY 2004, and USAID has completed an analysis and selection of agricultural "clusters" with greatest potential to raise rural incomes and generate employment. USAID and its partners initiated activities on cocoa, coffee and highland horticultural products (broccoli) clusters that created nearly 300 new jobs.

5. Economic Opportunities: USAID support to the Internal Revenue Service (SRI) has been critical to improve tax collections and administration. Tax revenue collections annualized for 2004 represent 16.8% of Gross Domestic Product. Support to prepare the country for the FTA negotiations has been successful, and GOE authorities as well as private sector officials have expressed satisfaction with the program.

The microfinance program has made significant progress. USAID increased the number of partners to expand microfinance services to a new total of twenty-two institutions, including two commercial banks. As a result, the number of credit clients has increased from 113,703 in FY 2001 to 259,546 in FY 2004. Portfolio at risk of more than 30 days for the assisted microfinance institutions achieved 3.9% in FY 2004, while the overall average for the microfinance industry in Ecuador is 6.1% and the average financial sustainability is over 100%.

## Results Framework

### **518-001 Biodiversity Conserved in Selected Protected Areas , Their Buffer Zones and Indigenous Territories**

**IR1.1** Adequate capacity developed to manage natural resources demonstrating transparent and accountable governance

**IR1.2** Sustainable natural resources management practices adopted

**IR1.3** Sustainable financing mechanisms contribute to conservation efforts

### **518-002 Increased Use of Sustainable Family Planning/Maternal Child Health Services**

### **518-011 Improved Social and Economic Conditions of Inhabitants along the Peru-Ecuador Border, Thereby Promoting Border Integration**

#### **SO Level Indicator(s):**

Number of beneficiaries in the target region whose lives are improved by access to social services, improved natural resources management practices and/or effective local governments.

**IR11.1** Increased access to major infrastructure.

**IR11.3** Increased availability and access to social services, with emphasis on health, water, and sanitation.

**IR11.4** Improved natural resource management in selected areas along the border.

**IR11.5** Increased private investment in the border area.

**IR11.6** Improved capacity of local governments to plan projects and implement services.

### **518-012 Increased Support for the Democratic System**

#### **SO Level Indicator(s):**

Decreased perception of corruption.

Increased legitimacy of justice system.

Increased legitimacy of local governments.

**IR12.1** Improved transparency and accountability of key democratic institutions.

**IR12.2** Greater inclusiveness of democratic processes.

**IR12.3** Increased policy consensus in key democratic areas.

### **518-013 Spread of the Andean Regional Coca/Cocaine Economy into Ecuador Contained**

#### **SO Level Indicator(s):**

Annual gross income per family increased

No more than 500 hectares of coca cultivated in Ecuador

**IR13.1** Citizen satisfaction with performance of local democratic institutions increased.

**IR13.2** Licit income and employment opportunities increased.

**IR13.3** More effective enforcement of laws related to counter narcotics and violent crimes.

**IR13.4** Government of Ecuador public forces more effectively defend security in northern border area.

**IR13.5** Ecuadorian public recognizes that coca/cocaine economy is a national problem.

### **518-014 Increased Economic Opportunities for the Poor**

#### **SO Level Indicator(s):**

Key governmental institutions strengthened for an improved macroeconomic environment.

Number of microfinance credit clients increased by approximately 350%

**IR14.1** Increased access to microfinance services.

**IR14.2** Macroeconomic policies/environment for more equitable growth improved.

**518-XXX Economic Growth**

**518-YYY Health Initiatives**